

2009 COMPETITIVE BID HEARINGS

Findings and Recommended Rental Rates for
Agricultural and Grazing Lease Nos.
5750, 6544, and 10006

A report to the State Board of Land Commissioners by
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On May 15, 2009 the Department recently held Competitive Bid Hearings for State of Montana Agricultural and Grazing Leases Nos. 5750, 6544, and 10006 which are being renewed in 2009. These new ten-year leases will expire on February 28, 2019. If a Lessee wishes to renew the lease for another term he must submit an application. If other persons inquire about the availability of a lease, their names and addresses are noted in the file and they are sent applications and bid forms at the time of lease renewal.

The statutory absolute preference right within Section 77-6-205(2), MCA, to renew a State agricultural and grazing lease was declared unconstitutional by Judge Jeffrey Sherlock in Broadbent v. State of Montana, et al., First Mont. Judic. Distr. Ct., Cause No. BDV-2003-361, because it impermissibly interfered with the constitutional power of the Land Board, under Art. X, Section 4 of the Montana Constitution, to choose its lessees. The Land Board, in response to Judge Sherlock's ruling, amended ARM 36.25.117 to exercise its constitutional prerogative to grant a qualified preference right to incumbent lessees in good standing. Through this rule, the Land Board has expressed its qualified preference to issue renewals of agricultural and grazing leases to the incumbent lessee provided that they have not committed illegal subleasing and do not have a history of lease violations. However, in all instances, the Board has reserved the right to choose the best-qualified lessee.

As part of its constitutional power, the Land Board may also determine the rate at which such leases will be issued. The Land Board has recognized that full market value encompasses the concept of sustained yield. Section 77-6-101 MCA. In Jerke v. State Dept. of Lands, 182 Mont. 294, at 296-297, 597 P.2d 49 at 50-51 (1979), the Montana Supreme Court held that a Grazing District which was not a lessee of a state grazing lease could not exercise a preference right. The Court described the rationale of the preference right to meet a high bid as follows:

Sustained yield is the policy which favors the long term productivity of the land over the short term return of income. State ex rel. Thompson v. Babcock, supra. The preference right seeks to further this policy by inducing the State's lessees to follow good agricultural practices and make improvements on the land. This is accomplished by guaranteeing that the lessees will not lose the benefits of their endeavors by being outbid when their leases terminate. They are preferred and may renew their leases by meeting the highest bid submitted.

Id.

Exercised in such a manner, such a preference is in the best financial interests of the school trust beneficiaries. All other things being equal, the Land Board has recognized that stability of land tenure encourages existing lessees to make greater improvements in the land, knowing that they will likely be able to utilize these improvements in the future, and that stability of tenure allows lessees to operate more efficiently. The duty to maximize revenue return to the trust estate from the trust properties is always subject to the duty to preserve the financial productivity of the trust lands. Oklahoma Education Association v. Nigh, 642 P.2d 230 at 238 (1982)

No Applicant for a grazing lease can compel the State Board of Land Commissioners to grant it an interest in state trust lands, especially where the concept of sustained yield is ignored. See, Skillman v. Department of State Lands, 188 Mont. 383, 613 P.2d 1389 (1980); Gibson v. Stewart, 50 Mont. 404, 147 P. 276 (1915)(Whether a tract of state land shall be leased is a question addressed to the sole discretion of the Land Board.); §77-6-206, MCA ([T]he board may withdraw any agricultural or grazing land from further leasing for such period as the board determines to be in the best interest of the state”).

Under ARM 36.25.117, if the Lessee exercises the qualified preference right but believes that the bid amount is excessive, he or she may request a hearing. The purpose of the hearing is twofold: 1) to

determine the best-qualified Lessee for the upcoming lease term; and 2) to ascertain the appropriate rental rate for that term. Specifically, the Director inquires whether the high bid amount represents the fair market value of the lease and whether the rental rate is truly in the best interests of the trust. In determining whether the "high bid" rental rate is in the best interests of the beneficiaries of the trust, the Land Board must utilize the criteria set out in §77-6-205(2), MCA, and in Thompson v. Babcock, 147 Mont. 46, 409 P.2d 808 (1966). Under these criteria, the Montana Supreme Court has held that the "high bid" may be rejected where it is either "...above community standards for a lease of such land, would cause damage to the tract, or impair its long-term productivity".

The Montana Supreme Court has recognized that an excessive rental rate, at some point, economically compels a Lessee to graze all the available forage on a grazing lease or reduce costly fertilizer, herbicide, and summer fallow treatments on agricultural leases. When state lands are over-grazed or farmed with minimal input costs, they produce more noxious weeds, less forage or crops, and less future income for the beneficiaries of the various trust lands. In extreme cases, the productivity of the land may be permanently damaged. It is in the best interests of the State to set a rental rate which balances the competing factors. In this "balancing act", the Land Board is attempting to maximize long-term income by allowing the Lessee a sufficient monetary incentive to exercise wise range management and agricultural practices. If the rate is too low, the State will not receive full market value for its lands. If the rate is too high, the Lessee will be induced to over-graze the tract, or reduce inputs such as herbicides, and long-term trust income will inevitably suffer.

In the competitive bid hearing process, the Director is recommending the rental rate for the next term of the grazing or agricultural lease. The economic viability of these leases fluctuates according to prevailing weather conditions and commodity prices; both of which can vary wildly. Despite these fluctuations, the grazing rental charged by the Board must be paid by the Lessee whether or not any forage upon the lease is utilized. By contrast, private lessors generally do not collect rentals when they no longer have forage available for lease. Consequently, setting an appropriate rental rate, so as to sustain the long-term viability of "school trust" leases and maximize long-term income, is simply not as easy as accepting the highest bid. If it were, there would be no need for a hearing on the subject.

The best lessee is chosen according to nine criteria set out within ARM 36.25.117:

- 1) an intended grazing or cropland management plan for the new term of the lease;
- 2) experience associated with the classified use of the land;
- 3) other non-state lands that are fenced and managed in common with the state land;
- 4) intended grazing or cropland improvements that will benefit the health and productivity of the state lands;
- 5) a weed management plan;
- 6) management goals and objectives and monitoring procedures to determine if they are being met;
- 7) the method or route used to access the state land;
- 8) any other information the director deems necessary in order to provide a recommendation to the board; and,
- 9) the incorporation of all or part of this information as terms and conditions in the new lease agreement.

The current policy of the Board authorizes the Director of the Department to hold the competitive bid hearings; hear the evidence; and make recommendations to the board. Since the rental rates must be based upon the evidence presented at the hearing, the Board members must avoid consideration of information outside the hearing record.

This year the Director granted three requests for hearing. The hearings were conducted on May 15, 2009 at the offices of the Department in Helena, Montana. The hearing was electronically recorded

and all witnesses testified under oath. However, the hearings were conducted in an informal manner. Present at the hearings were: Director, Mary Sexton; Trust Lands Management Division Administrator, Tom Schultz; Agriculture and Grazing Management Bureau Chief, Kevin Chappell; Trust Lands Attorney, Tommy Butler; Conrad Unit Manager Erik Eneboe, and Land Use Specialist Tony Nickel.

In preparation for this hearing, both the Lessee and the High Bidder were notified of the time and place of the hearing and given copies of ARM 36.25.117. In each hearing, the Lessee and the High Bidder appeared and presented testimony.

When appropriate to the hearing, the Commissioner accepted in the evidentiary record, the following evidence:

GRAZING

1. The Department's County Competitive Grazing Lease Bid Summary for Pondera, Toole, and Liberty County for 2009.
2. The Montana Agricultural Statistics Service Report of Grazing Fee Rates for private leases in Montana reporting an average rate of \$18.10/AUM.

The testimony and evidence considered during the hearing; a summary of the hearing; and the findings and conclusions recommended are set out as follows:

its private land for grazing for \$12.00/AUM.

Doug Larson is a Toole County farmer who proposes to manage this agricultural ground with no-till chem.-fallow techniques. He proposed to manage the cheatgrass by introducing a competitive plant species - Garrison creeping foxtail, which is palatable to livestock. He also proposed to build a livestock water reservoir and plant carregana for bird habitat. He would propose to spray the sagebrush and fence the grazing acres on this lease separately. He would drill a well upon the State land and spike it to re-seed it to tame pasture. His proposed route of access would be through the Southwest corner of the lease. He asserts that a county road would provide access.

Mr. Larson knows of 45% crop shares in Toole County and grazing rates of \$25.00/AUM on Tribal lands in nearby Glacier County.

Recommendation: The Director recommends that Camrose Colony be awarded the next term of this Lease at the rate of \$20.00 per AUM and the greater of 38% cropshare or a \$27.00 per acre cash guarantee. The Camrose Colony has experience with this tract and manages it in common with the State land. The continued weed management plan of spot spraying will adequately control noxious weeds. The Lessee should continue to monitor soil conditions through soil sampling. Camrose Colony has direct legal access to this tract by virtue of its ownership of adjacent private land. It is essential that the Lessee be able to access the State land in order to effectively manage it. Any issuance of this Lease to Camrose Colony should be upon the condition that Camrose Colony develop and implement a grazing management plan, which is acceptable to the Conrad Unit Office, for the grazing lands.

2009 COMPETITIVE BID HEARINGS

Hearing Time: Friday, May 15, 2009 @ 11:00 a.m.

Lease No.: 6544

County: Pondera

Lessee: Gerald Halverson

Tracts: T31N R4W S25: W $\frac{1}{2}$ SW $\frac{1}{4}$ - 80 Ac. – Common School Grant

T31N R4W S26: SE $\frac{1}{4}$, SW $\frac{1}{4}$ NE $\frac{1}{4}$, SE $\frac{1}{4}$ SW $\frac{1}{4}$ - 240 Ac. – Common School

T31N R4W S36: NW $\frac{1}{4}$ - 160 Ac. – Common School Grant

Grazing Acres: 372.96 AUM Rating: 81

Ag (CRP) Acres: 106.4

High Bidder: Mike O'Neal

High Bid: \$34.00 per AUM and the greater of 40% cropshare or \$60.00 per acre

Other Bids: None

Previous Rental: Minimum

Prevalent Community Rental Information:

State Land County Bid Averages: \$15.82 per AUM

32.54% cropshare or \$19.12/Ac

MT Ag Statistics 2007 Private Lease Rate: \$18.10/AUM

Gerald Halvorson, the Lessee, and Mike O'Neal, the High Bidder, appeared and testified. Mr. Halvorson testified that he currently has no livestock, and has sub-leased this tract. He admitted that in the past that this tract was over-grazed, but that the condition of the grazing acreage has improved with grazing restricted to the Fall season. The agricultural portion of this lease has been enrolled in the Conservation Reserve Program for the past 22 years. Typically, the Lessee has dealt with cheatgrass by hand-pulling. Mr. Halvorson has private land to the north and south of this tract. Mr. Halvorson admitted that he has previously sub-leased the grazing portion of this lease without seeking the prior permission of the Department. Mr. Halvorson would like to buy livestock in the future, but doubted whether he would actively farm this tract in the future due to the price of acquiring farm equipment.

Mr. O'Neal, the High Bidder, has a small number of livestock and is seeking to expand his

forage resources. He has looked at nearby Tribal lands, but the rental rate of \$26/AUM together with a trucking charge of \$4/AUM effectively would mean a \$30.00/AUM payment. This State tract would be much more convenient to Mr. O'Neal, because he would be able to check cattle more often. There are springs on this tract that would provide sufficient water for livestock. Mr. O'Neal testified that he would have access to this State tract from the west side. Mr. O'Neal proposed to utilize a four-pasture rest-rotation grazing management system, with electric cross-fencing. He would fence the CRP acreage separately. Mr. O'Neal testified as to his experience in farming and ranching, and stated that he would not sublease this State tract.

Recommendation: The Director recommends that the next term of this Lease be awarded to Mike O'Neal at the rate of \$34.00 per AUM and the greater of 40% cropshare or \$60.00 per acre cash guarantee. Mr. O'Neal has the requisite experience to manage an active livestock operation and his commitment to use a rest-rotation grazing program and to never sublease the tract will result in better rangeland health and productivity. The Department accepts Mr. O'Neal's testimony that he has legal access to this tract. It should be a condition of the next term of the Lease that the Lessee utilize a rest-rotation grazing management system, with the grazing acres fenced and separate pastures established by electric cross-fencing. The CRP acreage is to be separately fenced.

2009 COMPETITIVE BID HEARINGS

Hearing Time: Friday, May 15, 2009 @ 1:00 p.m.

Lease No.: 10006

County: Toole

Lessee: David & Lenora McEwen

Tracts: T36N R2E S10: NE $\frac{1}{4}$ NE $\frac{1}{4}$, NW $\frac{1}{4}$ NW $\frac{1}{4}$, NE $\frac{1}{4}$ SW $\frac{1}{4}$ - 120 Ac – Public Bldg.
T36N R2E S24: SW $\frac{1}{4}$ NE $\frac{1}{4}$ - 40 Ac. – Public Bldg. Grant

Grazing Acres: 157.59 AUM Rating: 40

Ag (Hay) Acres: 2.41

High Bidder: MCR LLC – Mac McDermott

High Bid: \$36.97 per AUM and the greater of 35% cropshare or \$50.00 per acre

Other Bids: None

Previous Rental: Minimum

Prevalent Community Rental Information:

State Land County Bid Averages: \$11.01 per AUM
45% cropshare or \$15.00/Ac

MT Ag Statistics 2008 Private Lease Rate: \$18.10/AUM

David McEwen appeared and testified on behalf of the Lessee. Mac McDermott and Gary McDermott, accompanied by their legal counsel, Chris Mangen, appeared and testified on behalf of the High Bidder. This Lease is comprised of four forty acres parcels spread through a larger tract of land held by the Lessee, David and Lenora McEwen. None of the parcels are fenced separately from the Lessee's private lands. There is no source of livestock water upon these tracts separate from the Lessee's water. Two of the parcels adjoin a ranch, which is in the process of being purchased by MCR, LLC. One parcel is located upon a county road. The remaining parcel in Section 24 is isolated and the High Bidder admitted that it has no legal access to that parcel. Mr. McEwen testified that he utilizes sheep to control the leafy spurge, and also spot sprays to control noxious weeds. Mr. McEwen manages these parcels using a seasonal rest-rotation grazing pattern.

Mr. Mac McDermott testified that MCR, LLC was in the process of purchasing private

lands to the north, and did not specify any particular management plan for these lands, other than to commit that MCR, LLC would probably hire a ranch manager who could devise a rotational grazing system. Mr. Mac McDermott has no personal experience in farm and ranch management. However Gary McDermott has several decades of experience as a CPA in advising agricultural operators on the financial aspects of farm and ranch businesses. Mac McDermott admitted that the High Bidder couldn't actively manage the State land in Section 24 due to a lack of legal access. Both Mr. McEwen and Mr. McDermott gave examples of local grazing rates in the range of \$8/AUM to \$12/AUM.

Recommendation: The Director recommends that the next term of this lease be awarded to David and Lenora McEwen, at the rate of \$11.00/AUM on the grazing acres, and at the rate of the greater of 35% cropshare or \$50.00 per acre on the agricultural acres. Mr. McEwen has considerable experience with the grazing of livestock and has legal access to all the parcels within this lease. The continued use of a seasonal rest-rotation grazing program in conjunction with Mr. McEwen's private lands will ensure the health and productivity of these rangelands. The use of sheep to control leafy spurge together with spot spraying of other noxious weeds should be adequate to control any weeds upon this State lease.